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INTERPROVINCIAL BARRIERS TO INTERNAL TRADE IN GOODS, SERVICES AND FLOWS OF CAPITAL: POLICY, KNOWLEDGE GAPS AND RESEARCH ISSUES*

Kathleen Macmillan, International Trade Policy Consultants Inc.
Patrick Grady, Global Economics Ltd.

Working Paper 2007-11

Canada

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Abstract

This paper summarizes the state of knowledge on internal barriers to trade in goods, services and flows of capital, examines their cost to the economy, and presents some options for addressing the important barriers that remain. A companion paper examines barriers to labour mobility in Canada (Grady and Macmillan, 2007). The paper finds that there is no single overriding research methodology that is most appealing, and suggests employing a methodology most suitable for the use to which the estimates would be put. Researchers could measure the cost of barriers with a case study approach because of its usefulness in focussing attention on specific barriers deserving of attention; update the 1983 and 1995 work of John Whalley, and others; or use computable general equilibrium models to test empirically the gains from increased trade. The study suggests that whether significant progress in dismantling barriers is achieved might well depend on factors such as whether parties abandon or stay with the current Agreement to Internal Trade (AIT) negotiating model. Good progress could also be made with the creation of bilateral and plurilateral agreements such as the Alberta-B.C. Trade, Investment and Labour Mobility Agreement and the recent Interim Agreement on agriculture as it allows like-minded parties to side-step the AIT's requirement for unanimous consensus. The study also concludes that economic events, such as labour shortages, may well drive the internal trade agenda in the next decade.

Key words: trade, trade barriers, internal trade

Résumé

Cette étude résume l'état des connaissances sur les obstacles internes au commerce des biens et services et au mouvement des capitaux, examine le coût de ces obstacles sur l'économie et présente quelques options pour l'élimination des importants obstacles qui restent. Un document complémentaire porte sur les obstacles à la mobilité de la main-d'oeuvre au Canada (Grady et Macmillan, 2007). Selon cette étude, aucune méthodologie de recherche n'est plus avantageuse que les autres et il faut employer la méthodologie la plus adaptée à l'utilisation qui sera faite des estimations. Les chercheurs pourraient mesurer le coût des obstacles en effectuant une étude de cas parce que ce type d'étude permet d'attirer l'attention sur les obstacles particuliers qui le méritent, mettre à jour les travaux de 1983 et de 1995 de John Whalley, ainsi que d'autres travaux, ou utiliser des modèles d'équilibre général calculable afin de vérifier de façon empirique les gains provenant de l'augmentation du commerce. Selon l'étude, la réalisation de progrès importants en matière de suppression d'obstacles pourrait bien dépendre de facteurs comme l'abandon ou non par les parties du modèle de négociation de l'Accord sur le commerce intérieur (ACI). Une bonne avancée pourrait également être accomplie grâce à la conclusion d'accords bilatéraux et plurilatéraux tels que l'entente sur le commerce, l'investissement et la mobilité de la main-d'oeuvre qu'ont conclue l'Alberta et la Colombie-Britannique de même que l'accord intérimaire sur l'agriculture, car de tels accords permettent aux parties animées par des préoccupations semblables de contourner l'exigence de l'ACI relative à l'obtention d'un

consentement unanime. Cette étude conclut que des phénomènes économiques, comme la pénurie de main-d'oeuvre, pourraient bien déterminer les priorités en matière de commerce intérieur au cours de la prochaine décennie.

Mots-clés : commerce, obstacles au commerce, commerce intérieur

INTRODUCTION

The past decade has seen tremendous progress on internal trade. In July 1995, the Agreement on Internal Trade (AIT) was entered into by all provincial and territorial governments and the federal government. The AIT sets down clear principles and some firm rules for the movement of goods, services and capital between provinces and territories. Under the AIT's action plan, its disciplines have been extended to cover additional sectors, notably in the area of government procurement. More recently, the B.C. and Alberta governments negotiated a comprehensive bilateral agreement, the Trade, Investment and Labour Mobility Agreement (TILMA). The B.C. - Alberta Agreement goes significantly further than the AIT and will substantially liberalize trade between the two provinces. Additionally, six provinces, including Alberta and B.C., have signed on to an accord committing themselves to ambitious reductions in technical barriers applying to food and agricultural products.

Despite the recent momentum, businesses and some governments remain frustrated with the slow pace of internal trade liberalization. There is a widespread belief, especially among members of the business community, that internal barriers to trade in goods, services and flows of capital are undermining the Canadian economy and jeopardizing the competitiveness of Canadian industry. This view has been given a thorough airing in ongoing hearings into the internal market being held by the Standing Senate Committee on Banking, Trade and Commerce. Yet there remains a scarcity of hard data and good research to substantiate the impression that barriers do, in fact, impose a significant cost on our economy.

In response to this renewed interest and apparent commitment to internal trade liberalization, Industry Canada and Human Resources and Social Development Canada have commissioned this paper to help focus discussions on information gaps and research priorities. This report is intended to be used as background material for an upcoming roundtable, the purpose of which is to launch a new research program on the important issue of the remaining barriers to internal trade and their cost.

This paper summarizes the state of knowledge on internal barriers to trade in goods, services and flows of capital, examines their cost to the economy, and presents some options for addressing the important barriers that remain. A companion paper examines barriers to labour mobility in Canada (Grady and Macmillan, 2007). It is divided into several sections. The first examines the economic cost of internal barriers to trade in goods, services and capital and reviews past research in this area. Section two of the paper considers options for addressing the main barriers that remain. Section three examines the B.C.-Alberta TILMA and the differences between it and the 1995 Agreement on Internal Trade (AIT). The fourth section of the paper returns to a consideration of the economic cost of internal trade barriers and presents some options for measuring the most significant impediments. The paper concludes with a discussion of future directions for internal trade.

HOW BIG IS THE INTERNAL TRADE PROBLEM?

A well functioning internal market is one of those motherhood objectives that is difficult to argue against. The frequent assertion that it is easier to trade with the United States than a neighbouring province became almost part of our national folklore.

Business leaders have championed the cause of internal trade liberalization for many years and have supported their appeals with surveys of their members and case studies demonstrating the effects of barriers.[1] Familiar examples, such as the inability to buy Moosehead beer outside New Brunswick have been used very effectively to attract public attention to the problem of internal trade barriers.

But how serious is the internal trade problem really? There is no doubt that companies are burdened by a plethora of competing regulations that can make it more difficult to do business outside their home regions. This adds to their costs, harms their international competitiveness and denies them growth opportunities. Trade impediments can also mean less choice for consumers and higher taxes in the case of preferential procurement practices. Barriers impose a cost on the economy in the form of efficiency losses which may or may not be considerable.

For internal trade barriers to be taken seriously as a policy priority, there needs to be some objective assessment made of the overall economic damage they cause. Policy makers would also benefit from a sense of which barriers create the most harm so that they can focus their attention accordingly.

Academic studies have, by and large, concluded that internal trade barriers have a minimal effect on overall gross domestic product (GDP). International institutions such as the International Monetary Fund also regard Canada's internal market as functioning relatively free from impediments. Internal trade practitioners have a similar view. Provincial and territorial internal trade representatives acknowledge that important barriers remain but admit that they are not inundated by calls from their business communities to address specific impediments to the movement of goods, capital and services. The small number of cases brought before the Agreement on Internal Trade's dispute settlement system lend support to the notion that trade in goods, services and capital within Canada is relatively unencumbered.[2]

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[1] For case studies of internal trade barriers, see, for example, Eugene Beaulieu, Jim Gaisford and Jim Higginson (2003). For public views on barriers, see COMPAS (2004).

[2] A total of 22 disputes involving goods, services and capital have been dealt with by the AIT's dispute settlement mechanism. Of those, four were resolved through consultations between the parties, one was withdrawn, seven are inactive and one was found to fall outside the AIT's scope. The remaining eight cases were the subject of AIT panel rulings. The panel upheld six challenges and denied two. http://www.ait-aci.ca/index_en/dispute.htm.

Academic Research

The most frequently cited academic work was done by John Whalley (1983) who concluded that barriers to internal trade have a minimal effect on our economy. In two articles contained in a 1983 report for the Ontario Economic Council, he estimated that the economic cost of internal barriers to trade and mobility accounted for at most between one-tenth and one-fifth of one per cent of national gross domestic product. Whalley observed that most barriers were product or instrument concentrated (for example, pertaining to beer, agricultural products, procurement, professional licensing, transportation regulation) and that there were few barriers affecting trade in manufactured goods. According to Whalley, while preferential government procurement practices amounted to the most substantial distortion to internal trade, these expenditures are wage and salary intensive and therefore have little effect on trade flows. There are few, if any restrictions on capital movements between provinces and territories since all function as part of global capital markets.

Whalley's analysis was based on Statistics Canada data on 1974 interprovincial flows of goods and services. He estimated that 17.5 per cent of internal trade was affected by barriers and assumed that the average *ad valorem* equivalent of internal trade barriers was 10 per cent. Assuming a 1 per cent interprovincial trade elasticity, his partial equilibrium estimate of welfare gains from eliminating interprovincial trade barriers was roughly 0.2 per cent of gross domestic product.

In a more recent report for Industry Canada, Whalley (1995) reexamined his earlier work by taking into account endogeneous growth considerations and the possibility that knowledge-based spillovers and externalities might accentuate the effects of interprovincial barriers. He found that taking these factors into account had little on his original results.

A study by Todd Rutley (1991) for the Canadian Manufacturers' Association (CMA) used a more basic, but similar, methodology to Whalley but found much more substantial effects. Rutley calculated that 10 to 15 per cent of GDP faced barriers to competition. In the case of government procurement, assuming a 5 per cent price premium, this amounted to $5 billion in extra costs. Preferential liquor and agricultural practices added another $1.5 billion in costs. In total, he concluded that interprovincial trade cost the Canadian economy $6.5 billion per year.

Copeland (1998) criticized the CMA estimates claiming that the report confused some international barriers with interprovincial barriers. He also contended that the positive effects of barriers were not taken into account when compiling net economic costs and that many of the barriers to trade in alcohol have since been dismantled . When the appropriate adjustments were made, the CMA analysis would demonstrate trade barriers as having an impact of only 0.05 to 0.1 per cent of GDP.

Another body of research has examined patterns in internal and international trade flows. According to Statistics Canada data, internal trade grew at a slower pace than international trade

during the 1990s, although this trend has reversed since 2000. Researchers concluded that the relatively weak performance of internal trade during the last decade was attributable to significant internal trade barriers. In fact, the explanation might have had more to do with reductions in foreign trade barriers under the GATT, WTO and NAFTA as well as with Canada's relatively weaker income performance compared to that of our foreign trading partners, notably the U.S. (Grady and Macmillan, 1998).

Studies using gravity models also supported the view that internal barriers do not impede trade to a significant extent. These models assumed that trade flows depend on physical distance and economic size, as measured by real GDP. They concluded that while preferential trade agreements affect trade flows between countries, even after controlling for distance and other relevant factors, there remained a strong preference to purchase goods in the home country. McCallum (1995) used a gravity model and data for 1988 to assess interprovincial trade and trade between Canadian provinces and American states. Later work by Helliwell (1996) and Engel and Rogers (1996) confirmed McCallum's results and showed substantial border effects. After taking distance and other relevant considerations into account, Canadian provinces were 15 to 20 times more likely to trade among themselves than with US states.

Helliwell, Lee and Messinger (1999) used a gravity model to assess the effects of the Canada-United States Free Trade Agreement. They showed that even with the substantial increase in cross-border trade that occurred as a result of tariff removal, border effects remained very strong. The fact that interprovincial trade ties were considerably stronger than bilateral ties suggest that the barriers to interprovincial trade are substantially less than barriers to trade with the United States even within the Canada-US free trade regime.

Progress in Reducing Barriers Since 1995

Most research into the cost of internal trade barriers was conducted in the 1980s and 1990s and did not take into account progress in reducing barriers accomplished as a result of the 1995 Agreement on Internal Trade. To the extent that they are based on barriers that no longer exist, research estimates of the economic costs of impediments to internal trade are overstated.

The most important advances made with the signing of the AIT and since were in the area of government procurement which is where both Whalley and Rutley considered the greatest trade impediments existed. The procurement chapter of the AIT brought important disciplines to government purchasing practices. The chapter was extended to cover procurement by the MASH sector (municipalities, municipal organizations, school boards and publicly-funded academic, health and social services) in 1999 and by crown corporations in 2005 accounting for $30 billion and $20 billion more respectively in annual purchasing. This has significantly reduced the number of government bodies excluded from the AIT's procurement rules.

Alcoholic beverages is another area that accounted for many of the economic costs estimated and where considerable progress has been made in reducing barriers since the Whalley and Rutley work was conducted. As a result of both GATT challenges and internal negotiations, beer marketing restrictions have largely disappeared and progress has been made on wine standards and distribution practices.

Most researchers concluded that the economic cost of internal trade barriers was already minimal. Taking into account reductions in barriers under the AIT, particularly in the critical areas of procurement and alcoholic beverages, it is reasonable to expect that the economic cost estimates would be lower still.

International Comparisons

Another way to evaluate the significance of internal trade barriers in Canada is to look at some international comparisons. When examined against other jurisdictions, Canada's internal market compares quite favourably.

Canada's government procurement measures are among the most open in the world. They are substantially more open than those in the U.S. where a large number of states, including California, provide explicit price advantages to local suppliers. Many others have reciprocal preference provisions that provide resident suppliers with a preference against non-resident suppliers equal to the preference given in the home state of the non-resident. Added to price preferences at the state level, there are a number of requirements on suppliers to use local materials, labour and equipment (Foreign Affairs and International Trade Canada, 2007).

In a 2005 background study to its Article IV Consultation process, the International Monetary Fund (2005) examined the flexibility of the Canadian economy. The study's results suggested that Canada's internal market is relatively free of impediments. It found that the Canadian economy is characterized by a relatively high degree of flexibility, higher than that exhibited by European countries like France, Germany and the United Kingdom and that Canada is relatively successful in shifting resources across sectors and workers between jobs.

A presentation by Douglas Brown (2001) compares economic union reform in Australia, the European Union and Canada. Brown outlines the ambitious micro-economic reform agenda undertaken in Australia which included measures providing for the mutual recognition of product standards and occupations, the establishment of national standards for food products and financial services and the creation of a national market in energy and water. Based on a report card approach that assesses reforms in a variety of sectors and institutional arrangements to enhance mobility and trade, Brown concludes that integration in Canada and Australia is now deeper than in the European Union.

OPTIONS FOR ADDRESSING THE BARRIERS THAT REMAIN

In considering ways to reduce barriers to trade in goods, capital and services, it makes sense to identify those barriers that cause the most economic harm. It also seems worthwhile to consider the ease with which barriers can be dismantled. Ideally, the greatest attention needs to be focused on those impediments that are least painful to eliminate and whose removal would yield the greatest economic benefits. In this way, the policy effort and political capital expended is somewhat commensurate with the scale of the problem.

While there is hardly a consensus among academics, businesses and government officials about which remaining barriers are the most important in restricting trade in goods, services and flows of capital, the most likely candidates for further research and policy attention are the following:

- Government procurement practices;
- Barriers to trade in agricultural and food products;
- Technical standards and regulation;
- Securities regulation; and
- Barriers to investment.

A recent report by the Canada West Foundation (2006) cited differences in regulatory standards and the local procurement policies of provincial and municipal governments as the most serious barriers to trade in goods, services and capital. A survey by The Canadian Chamber of Commerce (2004) identified overlapping regulations between jurisdictions, multiple licensing requirements and local preferences in awarding government contracts as the biggest obstacles facing businesses. In 2006, 186 companies responding to a Conference Board (2006) survey identified the barriers to competition that affected their ability to do business. The most common barriers cited were standards and regulations (41%), procurement (26%) and licensing requirements (20%). A survey of CEOs conducted by COMPAS (2004) indicated the interprovincial barriers (excluding labour mobility) that most concerned business leaders were, in order of importance, those relating to agriculture and food, transportation, procurement and investment.

Government Procurement

Substantial progress has been made under the AIT in imposing disciplines on public sector procurement practices. However, this is a huge area in terms of economic importance and there is still scope for improvement. In 2004-5, provincial and federal governments reported procurement expenditures of over $24 billion (MARCAN, 2006).

According to business surveys, some local preferences still exist. Examples include the Northwest Territories' requirement that contractor bids stipulate local labour, materials, and

equipment content and Quebec's requirement that firms bidding on contracts establish an office in the province (Canadian Chamber of Commerce, 2004). The AIT does not cover the purchasing activities of electrical utilities. For example, Hydro-Québec, which recently signed a procurement agreement with the state of New York that provides New York contractors access to its procurement opportunities, is not obliged to open its tendering to suppliers from other parts of Canada (except for the provisions covering construction in the recent Ontario-Quebec Construction Agreement). Neither does the AIT cover procurement contracts pertaining to services provided by licensed professionals such as medical, public relations, engineering and architectural services. While crown corporations were brought under the AIT procurement chapter in 2005, there is a long list of exceptions listed, particularly for federal crown corporations. Finally, while suppliers have access to effective bid challenge procedures in the case of federal procurement contracts, this is not the case for suppliers who wish to challenge awards made by provincial and territorial governments.

Another important exception is financial services. The AIT procurement chapter does not apply to the services of financial analysts or the management of investments by organizations dedicated to that purpose. It also excludes financial services relating to the management of government financial assets and liabilities. This is a significant exclusion given the size of government treasury bill operations requiring financial management.

It is reasonable to expect that parties will continue to make progress in liberalizing procurement practices through negotiation. The procurement chapter is one of the AIT's greatest successes. There is potential to build on that success by extending its coverage to important areas like utilities as well as by reducing the number of excluded entities and professional services.

It is unfortunate that no data are collected on the source of provincial and territorial government procurement expenditures. The methodology for preparing provincial economic accounts only enables Statistics Canada to identify that an interprovincial import of goods or services has been made and not the sector making the import. To get information on what governments procure from other provinces and territories, it would be necessary to have each provincial and territorial government provide sourcing identifiers in their procurement systems. Alternatively, surveys could be carried out to ascertain the provincial/territorial content of procurement expenditures in each jurisdiction. This information would have been useful to have because it would have shown if and by how much provincial and territorial government procurement from suppliers in other jurisdictions increased as a result of the AIT.

Agriculture

A large number of the remaining barriers to trade in goods are in the agricultural sector. There are outright prohibitions on interprovincial trade for supply-managed products like fluid milk. Technical standards ranging from sanitary and phyto-sanitary measures to labeling requirements impede internal trade in many products. Provincially regulated meat packing plants

are not able to sell outside their home province due to federal legislation. Agriculture accounts for many of the formal disputes handled by the AIT's dispute settlement provisions, including high profile disagreements over regulations governing margarine colouring and interprovincial shipments of fluid milk and edible oil products. Frequent disputes have arisen over technical standards such as grading for small potatoes and bulk shipments of apples.

The AIT agricultural provisions commit parties to very little beyond working together to reduce or eliminate certain specified measures identified as technical barriers to trade including five technical barriers with policy implications. Ministers have not reached a consensus on extending the chapter's scope. However, they have committed to present the Council of Federation with an action plan that "includes all technical measures, ensuring that any new agreement does not interfere with Canada's orderly marketing systems."

Out of concern with continuing delays in reaching a consensus on revised text for the AIT Agricultural and Food Goods chapter, six governments, British Columbia, Alberta, Saskatchewan, Manitoba, Prince Edward Island and the Yukon Territory, signed the Interim Agreement on Internal Trade in Agriculture and Food Goods in 2006. The Interim Agreement reaffirms commitment to the AIT's objective of reducing technical barriers to trade in food and agricultural products and extends the scope of negotiations beyond the list of technical barriers identified in the AIT to cover all technical barriers to trade.

The highly contentious issue of supply management will likely continue to impede progress in agricultural negotiations in the future. Despite assurances that Canada's supply management system will not be affected by the negotiations, some parties are still reluctant to enter into discussions of technical barriers to trade since some of these measures could have consequences for the supply management system.

It is difficult to see much potential for progress in the near term. The AIT contains very little in the way of commitments with respect to agriculture. Even still, almost nothing has been accomplished since 1995. The same agricultural barriers that plague internal trade in Canada are contentious issues in the international trade forum as well. A number of parties to the AIT believe that progress in internal trade in agricultural and food products should wait for reforms in international negotiations.

Technical Standards and Regulation

Business organizations identify overlapping, inconsistent and excess regulation as the single largest impediment to trade within Canada. According to groups such as the Canadian Chamber of Commerce, the Canadian Council of Chief Executives and the Conference Board, the lack of coordination leads to unnecessary duplication that is very costly and can even prevent firms from doing business in other provinces.

Among the regulations cited as being the largest irritants are those governing highway transportation, construction safety, the certification of industrial equipment, labeling and packaging, financial services registration and environmental reporting.

Impediments in the transportation area are particularly important since they affect the provision of the transportation service itself as well as impeding trade in the items being shipped. In a geographically large country such as Canada where many transported products are resource products for which we are price-takers in world markets, this translates into smaller returns to goods producers (Bonsor, 2004). The lack of uniform standards in Canada for such things as truck dimensions, allowable weights, hours of service, and load limits make it more complicated and costly to transport goods between provinces. While progress has been made in recent years to coordinate requirements, important differences still remain.

Corporate registration is another big area of concern for the business community. It is especially important in the financial services industry where it concerns the registration of mortgage brokers, insurance agents and securities brokers. The requirement to separately register in each province or territory in which they do business impedes the flow of capital and adds cost. British Columbia and Alberta have agreed under the TILMA to eliminate the need for separate registration. The Atlantic provinces are working towards a similar agreement to recognize corporations registered in other Atlantic jurisdictions.

Among the other restrictions identified are requirements affecting pharmaceutical manufacturers and retailers. Cumbersome procedures exist to have drugs accepted for provincial approvals lists. As well, there are impediments to retail pharmacies such as restrictions on filling prescriptions for out-of-province residents and different provincial labeling and distribution requirements.

It is very difficult to assess the effect of government standards and regulations on internal trade. Much of the difficulty arises from the lack of consensus on what constitutes a trade barrier. What the business community perceives as excessive and unnecessary regulation, others might perceive as discretionary provincial and territorial regulation in areas of legitimate jurisdiction. Very few barriers remain that were explicitly designed as protectionist measures.[3] Rather, the patchwork of overlapping measures is the legacy from years of separate rule-making in different jurisdictions.

According to Copeland, the challenge has more to do with regulatory reform than with the dismantling of trade barriers:

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[3] Businesses still cite examples of some explicit barriers, however. The *Transportation of Dangerous Goods Act* evidently permits Québec companies to ship goods to foreign countries without using UN packaging but requires companies in other provinces to use UN-approved packaging. (Conference Board, 2006, p. 25).

> The fundamental issues in this policy debate are not principally issues of trade. Rather, they have to do with the appropriate division of powers between governments, the tradeoff between diversity and harmonization in policies, and the proper role of government in influencing the direction of the economy. Instead of muddying the waters by framing the debate in terms of trade barriers, the focus should be on the real issue, which is regulatory reform.(Copeland, 1998)

What is agreed is that the task of harmonizing and reconciling incompatible barriers is a massive one. Before meaningful progress can be made in reconciling standards and regulations under the AIT, the measures have to be identified, compared and analyzed. This requires an examination of literally thousands of pieces of legislation in effect at the provincial, territorial and federal levels. British Columbia and Alberta are experiencing this firsthand as they endeavour to comply with their TILMA commitments. There are over 10,000 separate measures dealing with the financial services sector in British Columbia alone.

Fortunately, parallel efforts in the area of regulatory reform could offer some assistance. Work on the federally-initiated SMART Regulation project has helped to identify areas of regulatory overlap and has developed principles that could be applied to test the validity of any regulation. Reports are, however, that the project lacks the political profile it needs to be taken seriously.

Other regulatory streamlining initiatives offer potential. The Manitoba government has introduced technology-based measures to reduce the cost of regulatory compliance. One initiative is Biz Pal, a web-based service that will allow businesses to customize their own list of permits and licenses required from all three levels of governments (Manitoba, 2006). Other governments are involved in similar initiatives aimed at cutting red-tape. While they are not necessarily directed at eliminating overlaps in regulation across levels of government, this might be an indirect outcome of the exercise.

The significant job of compiling and analyzing provincial, territorial and federal technical regulations has also been advanced by work done by provinces and territories to comply with the notification requirements of the WTO Agreement on Technical Barriers to Trade. As part of the WTO GATS negotiations, governments have provided notification of the technical barriers they wanted included on the reservation list. This list provides an inventory of technical standards that could be compared and used as a basis for negotiations aimed at harmonization (Ontario Ministry of Economic Development and Trade, 2005).

Any progress in reconciling barriers will require tough choices. Provincial and territorial regulators can be reluctant to cede jurisdiction in this area by recognizing the standards of other jurisdictions or regulations administered by national bodies like the Canadian Standards Association. Ironically, most provinces consider that their own standards are the highest in the country and refuse to "harmonize down".

An alternative to a "bottoms-up" approach to reconciling technical standards is to make

mutual recognition mandatory. There are plenty of examples of jurisdictions that have done this. A 1992 agreement between the Australian federal and state government (the MRA) provided for the mutual recognition of standards relating to goods and occupations. Five years later, Australia agreed to recognize New Zealand's regulatory standards pertaining to goods and services under the Trans Tasman Mutual Recognition Agreement (the TTMRA). The Australian Productivity Commission describes the initiative as follows:

> In contrast to Canada, where mutual recognition is extended on a case-by-case basis, under the MRA and TTMRA all goods and regulated occupations are subject to mutual recognition unless specifically excluded. By limiting the scope and choosing an opt-out model, Australia and New Zealand have designed a scheme that is not administratively burdensome and avoids extensive protracted negotiations. (Australia, 2003)

The Australia and New Zealand agreements apply only to the sale of goods and the registration of occupations. They do not cover such issues as the manner of sale, transportation, storage, handling, inspection or usage or to the manner of delivery or provision of services. In contrast, the mutual recognition agreements in the European Union pertain to all measures that might restrict sales. The European Union requires that member states mutually recognize a host of certification and licensing standards. EU directives have established common standards governing telecommunications, and road and air transportation.

The TILMA also takes a top down approach to reconciling technical measures by making mutual reconciliation the default condition unless provincial measures are explicitly exempted. In the process of reviewing regulatory legislation, the two provinces have found many inconsistent measures that made no sense and were easy to resolve. One example is that both provinces stipulated that oilfield workers maintain a first aid kit at their workplace but the two provinces had different requirements for what the kits should contain. It was an easy matter to arrive at common standards once presented with the situation.

Securities Regulation

Securities regulation in Canada is separately governed by the provinces and territories. Companies that want to market securities in Canada have had to comply with the requirements of 13 separate regulators and pay fees to each jurisdiction. This translates into extra costs in terms of executive time and professional expenses. It also means delays in filing and marketing securities. The fragmented regulatory system could also dissuade foreign investors and contribute to lapses in enforcement.

A single national securities commission is a big issue for the business community. In recent years, both the federal and Ontario governments have established committees to raise

awareness of the issue and recommend ways to implement a single regulator system.[4] The federal Minister of Finance (Flaherty, 2006) has highlighted the need for a single national securities commission in recent speeches and in his latest budget.

The provinces and territories have worked over the years to streamline the regulatory burden and share information but security issuers still face a cumbersome and costly process with unpredictable outcomes. In 2004 some provinces signed on to the Securities Passport System that allows issuers to deal with only one regulator and exempts them from legal requirements of other jurisdictions. However, the Ontario Securities Commission, which accounts for 83 per cent of Canada's total listed market capitalization, still insists on performing its own compliance exercise and refuses to recognize the results of another commission.

A study prepared by Charles River Associates (2003) concluded that a single national regulator with regional offices would save Canadians $45 million per year in regulatory expenses. In addition, TSX and TSX Venture Exchange issuers would save $14 million annually in compliance costs.

Investment

Some provinces make the approval of certain investments conditional on local employment or procurement. This is the case for petroleum and gas projects in Newfoundland and Labrador, for petroleum exploration projects in Nova Scotia and for mining ventures in New Brunswick. Alberta also imposes restrictions on petrochemical companies that strip hydrocarbons from natural gas transmitted in the province. The Territorial Governments impose numerous local employment or procurement conditions, particularly for resource investments. Governments claim they use their discretion in applying these requirements and often disregard them in the current environment of labour shortages. However, the rules remain on the books.

Investment restrictions are not limited to resource developments. Nova Scotia reserves right to restrict ownership of recreational shore land. Prince Edward Island levies different taxes on the commercial holdings of residents and non-residents.

Negotiations on the AIT's energy chapter, which are near completion, are likely to address investment requirements in the petroleum and natural gas sectors. With respect to investment restrictions generally, local content and local processing requirements are prohibited by the EU, and under the GATT and NAFTA (Goodman and Frost, 2000). This is an option that needs to be considered for the AIT.

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[4] In 2003, the Federal Minister of Finance established the Wise Persons' Committee to independently assess what securities regulatory structure would best serve Canada's interests. In 2005, the Ontario Minister responsible for securities regulation created the Crawford Panel on a Single Canadian Securities Regulator to make recommendations on a model for a single securities regulator, a common body of securities law and a single fee structure.

THE BC-ALBERTA TRADE, INVESTMENT AND LABOUR MOBILITY AGREEMENT

In April 2006, British Columbia and Alberta agreed to enter into a comprehensive Trade, Investment and Labour Mobility Agreement (TILMA). The agreement came into force in April 2007 with some provisions only taking effect in April 2009. The motivation for entering into the TILMA was general dissatisfaction with the architecture of the AIT as well as with the slow progress in the implementation of the AIT (Conference Board of Canada, 2005).

The basic architecture of TILMA is quite different from that of the AIT. All measures that restrict or impair trade, investment and labour mobility are subject to the disciplines of the TILMA unless they are explicitly excluded. Under the AIT, in most cases, only measures that are explicitly included are those that fall within the scope of the agreement.

The TILMA goes further than the AIT in the following areas:

- In the area of investment, there will no longer be any requirements for investors in Alberta or B.C. to set up local offices or maintain local agents. The TILMA also eliminates the need for separate business registration for investors and business owners in the two provinces.

- Business subsidies are subject to stricter disciplines than under the AIT. Parties are prohibited from offering subsidies to attract or encourage the relocation of business enterprises to the other province or provide an advantage to an enterprise over a competitor in the other province. The AIT's Code of Conduct on Incentives primarily pertain to anti-poaching measures and provide broad exemptions for such things as grants to cultural entities and for regional development purposes.

- Government procurement is more broadly covered under the TILMA than under the AIT. The TILMA threshold for the review of goods is $10,000 compared to $25,000 under the AIT and $75,000 for services compared to $100,000 under the AIT. In addition, the TILMA covers procurement related to the privatization of government services, assets or enterprises. It also establishes a mechanism for joint tender notices.

- The TILMA's energy provisions provide for non-discriminatory access to and use of energy goods and services to, from, within or through the territory of each province. The AIT's energy provisions were left for future negotiation.

- The TILMA addresses specific issues in the transportation sector. It provides that commercial vehicles licensed in one province will automatically be recognized and allowed to do business in the other.

- While the TILMA contains no specific provisions relating to agriculture, it is presumed to fall within the general rules governing trade. Accordingly, the two provinces will work towards the harmonization of all agricultural standards and regulations.

- Non-agricultural standards and regulations will also be harmonized and the two provinces will avoid any new measures that might impair trade or investment. This is in contrast to the AIT's approach which is to negotiate the inclusion of standards on a case-by-case basis.

- The TILMA contains a more effective dispute resolution mechanism than that of the AIT. Like the AIT, the TILMA encourages the resolution of disputes through consultation and mediation. However, disputes that cannot be resolved this way are subject under the TILMA to the ruling of an arbitration panel that is binding. Panels can order money awards of up to $5 million to individuals and businesses that successfully challenge a barrier to internal trade, investment or labour mobility.

The TILMA has forced other parties to take a closer look at the AIT deadlines and address unfinished business with renewed vigour. The degree of enthusiasm for the TILMA varies from province to province with some believing that the TILMA has not been helpful in that it has distracted governments from the AIT agenda.

Provinces and territories are also in the process of reviewing the TILMA since under the accession Clause 1800 of the AIT, other parties could choose to join the bilateral agreement. For now, this is a remote possibility although several provinces have held preliminary discussions with British Columbia and Alberta. Most believe that the TILMA is tailored to the B.C. and Alberta situation and would be less applicable to other parts of the country.

A more likely scenario would be for parties to import some elements of the TILMA into the AIT. Some have expressed interest in certain sections of the agreement, notably the TILMA's energy and dispute settlement provisions. The recent Interim Agreement on Internal Trade in Agriculture and Food Goods, which has been signed by six provinces, takes much the same approach as the TILMA does to agriculture.

Other governments have raised concerns about some parts of the TILMA. The suggestion has been made, for example, that the definition of business subsidies contained in the TILMA is incompatible with that set out in the WTO's Agreement on Subsidies and Countervailing Measures. A specific concern is that this inconsistency could leave Canada open to WTO challenges by foreign trading partners. More generally with respect to subsidies, some parties would have difficulty agreeing to the strict disciplines imposed by the TILMA, especially as they relate to regional development assistance.

A recent study by the Conference Board (2005) commissioned by the B.C. government assessed the likely impact of the TILMA concluded that it has the potential to add $4.8 billion to provincial real GDP and create 78,000 new jobs in the province. The Conference Board based this estimate on a survey of six government ministries and four private businesses in the province who were asked to rate the impact of TILMA's provisions on a seven-point scale ranging from -3 to +3 with -3 indicating a significant challenge (a negative impact greater than 10 per cent of GDP), -2 a moderate challenge (a negative impact between 5 and 10 per cent of GDP), -1 a small challenge (a negative impact between 0 and 5 per cent of GDP), 0 no impact or not applicable, +1 a small benefit (a positive impact between 0 and 5 per cent of GDP), +2 a moderate benefit (a positive impact between 5 and 10 per cent of GDP), and +3 a significant challenge (a positive impact greater than 10 per cent of GDP). Judgement was applied to the survey results to attribute scores to various industries and regions and an overall score of 0.76 was calculated as a weighted sum of the industrial and regional scores. Applying the 0.76 factor to the 5-per-cent of GDP corresponding to one on the scale yielded an overall impact on the provincial economy of 3.8 per cent or $4.8 billion. This estimate falls far well outside the bounds of the other estimates of the impact of removing internal trade barriers. The exaggerated estimates obtained by the Conference Board are due, no doubt, to a number of technical problems with the methodology employed that have been identified (Grady, 2007).

RECOMMENDATIONS FOR FURTHER RESEARCH

Without reliable and up-to-date estimates of the cost of internal trade barriers, it is hard to make real progress on internal trade liberalization. Those opposed to reductions in barriers can claim that trade impediments are inconsequential and not worth worrying about. Those in favour of radical reductions can create an atmosphere of crisis that does not help advance Canada's reputation among foreign and domestic investors. There is no doubt that credible estimates would greatly assist the policy debate by allowing policy makers to focus their energies on those barriers that cause the most economic damage.

There are several possible approaches that researchers could use to measure the cost of barriers.

One is the case study approach. Business organizations have compiled information provided by companies on the cost of regulatory overlap and duplication. For example, Enbridge Inc. has calculated that regulatory duplication costs the company $5 to $10 million per year in addition to the legal fees and manpower necessary to comply with the requirements of different jurisdictions (Conference Board, 2005, p. 24). Measures are also available of the costs in terms of lost business to companies that are prevented from operating in other provinces because of requirements to re-register or comply with different standards.

The case study approach is useful in focusing attention on specific barriers deserving of attention. This is critical information when establishing negotiating priorities. It is less helpful in

providing a picture of broader economic costs. Even if the anecdotal estimates could be compiled with any reliability, it is difficult to move from the specific to overall estimates of losses in economic efficiency.

A second approach would be to update the work done by Whalley (1983, 1995) and others. Whalley's approach remains theoretically valid even if the amount of protection afforded by trade barriers has fallen over time. In the area of procurement, there are no longer explicit price preferences for procurement covered by the AIT as there were when the original estimates were prepared. However, for excluded procurement, and even in those covered sectors, it is reasonable to assume that some degree of local preference might persist and can be quantified. This is certainly the view of members of the business community. To estimate the overall effect on taxpayers of the local preferences in procurement, researchers would have to assign a price factor to procurement preferences. This would also be the case for preferential practices relating to alcoholic beverages and agriculture. Assumptions would also have to be made concerning supply and demand elasticities.

Computable General Equilibrium (CGE) models could also be used to test empirically the gains from increased trade. A number of studies employed CGE models to estimate the effects of the Canada-United States Free Trade Agreement and the North American Free Trade Agreement. While the studies showed net gains from trade liberalization, results differed according to the assumptions made about the nature of competition and potential to exploit economies of scale. CGE models can be either static or dynamic in nature, the latter attempting to capture the effects of capital accumulation and knowledge transfer.

The difficulty in applying CGE models to the internal trade situation is that there are no tariffs to be eliminated. Consequently, assumptions need to be made to convert non-tariff barriers to tariff equivalents and to estimate price impacts since the models need price shocks in order to calculate the effects of changes in the trade regime.

The price effects of non-tariff barriers were addressed by Copenhagen Economics (2005) in its comprehensive study of the cost of EU barriers to trade in the services sector. Stage one of the study involved compiling a detailed data base of restrictions in the internal market based on surveys with businesses. The various restrictions were organized into over 40 different sub-categories. Using index methodology, the restrictions were then converted into quantitative measures called Internal Market Restrictiveness Indices in Services (IMRIS). In the second stage of the analysis, the IMRIS values were converted into tariff equivalents that measured the economic effects of the service barriers. In the final stage of the study, the tariff equivalents were used to calculate the economy-wide effects of reductions in barriers in a computable general equilibrium model.

The Copenhagen model analyzed several different policy scenarios for reducing barriers to trade in services including the Commission's proposed Services Directive which provides for freedom of establishment for service providers and the free movement of services. The results

showed that adopting the proposed Service Directive would increase EU consumption by 0.6 per cent or €37 billion. Productivity would also increase causing job losses in some sectors. The net increase in employment would be 600,000 jobs. Output would rise in all sectors of the EU economy and the total value added in the services sector would increase by €33 billion.

While the Copenhagen Economics approach is appealing, it would be difficult to apply to the Canadian situation without a clearer domestic game plan for reductions in barriers. In its study of the EU, Copenhagen Economics analyzed the status quo in relation to the Commission's proposed Services Directive. In the absence of a similar objective for Canada, researchers would have to decide themselves which regulations are necessary and which are superfluous. While few would argue that it is not desirable to have meat inspectors at meat-packing plants, for example, how many is too many? It might be possible to measure the effect of regulation on the overall economy. It is considerably harder to measure the effects of excess regulation.

The Conference Board (2005) avoided this in its assessment of barriers to competition on Canadian productivity by comparing the Canadian regulatory regime to that of the United States. It compared Canadian and U.S. prices for a list of goods and services and, after making corrections for such things as indirect taxes, exchange rates, and transportation costs, attributed price differences observed to levels of regulation. The Conference Board found that the regulatory wedge between Canada and the United States was in the order of 15 per cent. The study probably overstated the barriers to competition in Canada since it did not take into account other factors such as Canada's harsher climate, higher taxation levels, smaller scale or generally higher standards of regulation overall that could explain part of the price differences.

The Conference Board study did not attempt to isolate the effects of internal trade barriers on price differences. The methodology might have some merit if used to study internal barriers since persistent price differences between regions could well be indicative of barriers to competition. This approach might hold promise for evaluating the degree of protection to milk producers in different provinces and territories, for example. Significant price variations across the country would suggests that natural forces of arbitrage were impeded by the presence of barriers.

In the end, there is no single overriding methodology that is the most appealing. Rather, the methodology employed depends on the use to which the estimates would be put. Case studies and business surveys are the best approach if the objective is to establish negotiating priorities. CGE models are desirable because they provide a single estimate of overall effects (taking into account indirect as well as direct effects) and therefore can show how important or unimportant barriers really are. However, to be truly useful CGE models require reliable estimates of the direct impact of all the most important barriers, which unfortunately do not exist.

To make progress in specific areas tailored approaches are probably needed. The business community has identified overlapping technical measures and regulations as the most significant trade impediment they face. A comprehensive approach is needed first to identify these measures

and assess the degree of protection they provide. The next step is to evaluate the effects of reducing the barriers to some new lower level. Deciding what that level should be is a matter for policy consideration. In terms of research challenges, this is the largest.

OPTIONS FOR IMPROVING INTERNAL TRADE

Economic events may well drive the internal trade agenda in the next decade. Shortages of labour make it very difficult to meet the demands of major projects and are straining service providers across the country. Issues such as impediments to the transportation of heavy construction and industrial equipment across borders are occupying the attention of provincial and territorial officials. So too are concerns that Canada's fragmented regulatory system is giving foreign investors a negative perception of Canada. The result is that, with the exception of the agricultural sector, there appears to be less interest in protectionist policies aimed at employment creation than there was ten years ago and more emphasis on reducing those barriers that make no sense.

Whether significant progress is achieved might well depend on whether parties abandon or stay with the current negotiating model. The AIT is essentially a political agreement that provides a framework for discussions among officials. Some claim that the AIT's "best efforts" model is the most suitable since it is respectful of the legitimate constitutional powers of member governments. Had firmer chapter rules and a binding dispute settlement mechanism been included, parties might have been loath to make the commitments they did elsewhere in the Agreement. Public consultations conducted by the Internal Trade Secretariat in 2002 found that with the exception of business representatives, participants and panelists overwhelmingly favoured keeping the AIT as a political rather than legal agreement (Internal Trade Secretariat, 2002, p.9).

Some proponents of the current approach even claim that there is a real danger in strengthening the AIT. To the extent that it is incompatible with Canada's international trade obligations, it could be used by foreign governments to challenge government measures. Scott Sinclair (2001) argues that this is what occurred in the NAFTA investor-state challenge of Canada's MMT gasoline additive measures.

The alternate view is that the consensus-building model of the AIT has reached the limits of its capabilities. Critics point to the absence of rules in important areas like agriculture and energy and the minimal progress that has been achieved in extending the agreement. While creation of the Council of Federation has added some critical political impetus, there is often a disconnect between the will of Ministers and the ability of officials to deliver at the negotiating table. To be fair, the sheer magnitude of rules, regulations and standards make it very difficult to achieve negotiating breakthroughs under the AIT's "bottom-up" model.

What is needed, some say, is for parties to replace the AIT structure with the reverse-onus

model adopted by the TILMA and in place in the NAFTA and WTO agreements. Instead of leaving everything outside its coverage unless negotiated in, which the AIT does in most instances, the agreement should make mutual recognition the default situation unless specific exceptions are negotiated. Added to this should be a dispute settlement system that promises parties a final and binding outcomes if governments do not live up to their obligations. This would put the onus on governments to address the large number of overlapping standards that concern the business community.

Some maintain that governments should look at constitutional challenges as a way of dismantling barriers. The Commerce and Supremacy clauses of the U.S. Constitution have been used to successfully challenge the constitutionality of state actions affecting interstate commerce. The EU's Treaty of Rome provisions prohibiting measures "capable of hindering, directly or indirectly, actually or potentially, intra-Community trade" have been used by litigants to support freer trade. This is an area that has not been tested in Canada primarily because legal experts are uncertain about the powers of Section 121 of the Constitution Act of 1867. The section which specifies that "all articles of growth, produce or manufacture of any of the Provinces shall, from and after the Union, be admitted free into each of the other Provinces" has been interpreted only to apply to tariffs and taxes on interprovincial trade.

In the meantime, the best hope for progress lies with the creation of bilateral and plurilateral agreements such as the TILMA and the recent Interim Agreement on agriculture. This allows like-minded parties to side-step the AIT's requirement for unanimous consensus. Other governments can join these agreements at a later date, or, alternatively, elements of the bilateral/plurilateral agreements can be imported into the AIT. The push for progress from the Council of the Federation will also be very helpful. The resulting action plan established by the Committee on Internal Trade and reported by Premier Doer to the COF in a letter confirms that there is indeed a renewed commitment for action with specific deadlines (Council of the Federation, 2006).

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